



MEMORANDUM

DATE: November 13, 2013

TO: California Secure Choice Retirement Savings Investment Board

FROM: Brad Wenger, President and CEO, ACLHIC
John Mangan, Regional Vice President, ACLI

RE: RFI Comments – CA Secure Choice Retirement Savings Program

The Association of California Life and Health Insurance Companies (ACLHIC), representing many of the largest life and health insurers doing business in California, and The American Council of Life Insurers (ACLI) representing more than 280 life insurers nationwide, respectfully submit the below comments for your consideration.

California Secure Choice Retirement Savings Program

As participants in the legislative discussions concerning SB 1234, we have attached information relevant to the Board's Request for Information (RFI) and also a compilation of our member company comments which are set forth below. We urge the Board to enter into a dialogue with respondents to the RFI before an RFP is prepared. We believe that a discussion involving all stakeholders will yield a more productive RFP process that will assist the Board as it goes about its work.

Overview

Over the last several decades, the defined contribution (DC) system in the United States has grown and has evolved to better meet the needs of employers and participants. According to the U.S. Department of Labor's Bureau of Labor Statistics, almost 80 percent of full-time workers have access to employer-sponsored retirement plans, and more than 80 percent of workers with access to plans participate. When one includes all part-time and seasonal workers, 68 percent have access to employer-sponsored retirement plans, and 79 percent of workers with access participate. DC plans now comprise the majority of these plans, and IRA solutions are available for those who do not have access to an employer-provided plan.

We agree that improvements should be made to the current system to encourage more employers to offer plans to their employees. However, these improvements can be made within the current private sector system. We urge the Board to consider our comments below, and restate our desire to work in partnership with the Board to achieve greater retirement security for all Californians.

RFI Questions

Plan Structure

Employers today have a number of options to design a benefit program to suit their needs within their budget. Many of these plan types were created with the needs of small employers in mind. The private sector offers a wide range of products and services to implement and support these plans. The Board should review these plans and the various product options currently available to employers. We expect it will find that a separate state-run plan is unnecessary.

Investment Options

Many qualified retirement plans and IRAs offer guaranteed fixed returns under binding contracts issued by insurance companies. While guaranteed returns are not unique, the California program appears unusual in that it would not pass through trust earnings directly to account holders, but credit “interest” to workers at a rate set by the Board. Also, it would set aside a portion of the trust’s earnings in a “reserve account” to be used as a credit against future losses. The Board should confirm that this is a correct reading of the program.

Individual retirement accounts (IRAs) must pass through all gains and losses of the account holder’s investments to the account holder. The Board should confirm with the IRS and Treasury that, under the Internal Revenue Code, the custodian/trustee of an individual account plan must fully allocate the earnings of the trust to the individual accounts each year.

The California program intends to purchase insurance to provide its “guaranteed return.” Absent the use of guaranteed fixed-return contracts, California may find it difficult and/or costly to hedge its bond, equity and other investments against losses, or to purchase insurance to guarantee the rate set by the Board. As the New America Foundation notes, the cost of hedging these investments, if such hedging is available, will require the Board to “credit” an even lower rate to workers’ savings. If it is determined that the Board could offer such a program, the Board must consider and address what party or parties will make worker accounts whole should the guaranteed rate exceed both the trust’s gains and the limits of its hedging and insurance.

Costs and Fees

Under the law, the State of California will not contribute at all to the cost of the program. The legislation sets a 1.0 percent cap on administrative fees. However, there is no cap on other fees and expenses. Thus, under the legislation, workers' savings will be further reduced by other expenses. Investment management costs, the costs of a program administrator, the costs of a funding mechanism to protect the value of the accounts and hold the state harmless, and charges submitted by the Employment Development Department are to be paid out of the trust and are not to be attributed to the administrative costs. It appears that these costs and the administrative fees will be applied against the trust before the gains, if any are left, are credited to workers' savings.

It has been estimated that the California program expenses could be as high as 2 to 3 percent a year. We believe more cost-effective savings could be achieved today through private-sector plans and IRAs. The Board's report to the Legislature should detail the maximum anticipated expenses to be deducted from workers' savings in total and by category.

Legal Issues

Under the law, California will institute a plan only if the plan will not be subject to the Employee Retirement Income Security Act (ERISA), a federal law enacted to protect the interests of private sector workers and their beneficiaries. Our understanding is that the Board intends to request from the U.S. Department of Labor (DOL) an Advisory Opinion as to whether a plan is subject to Title I of the Employee Retirement Income Security Act. The Board should specifically address in RFPs sent to potential vendors the expected work of preparing, submitting and obtaining such an opinion.

The law also requires the Board to ensure a mechanism is in place that "holds the state harmless" at all times against any and all liability in connection with funding retirement benefits under the law. The Board should request that the DOL opine as to whether the State of California, the Board, and those with Board appointment authority are fiduciaries of the plan.

Upon request of the Board, the Department of the Treasury may grant the Board custodial authority to operate individual retirement accounts. As we noted earlier, we expect Treasury will find the program's reserve account inconsistent with a plan or arrangement with individual accounts under Chapter 1, Subchapter D, Part I, Subpart A of the Internal Revenue Code. In its filing with the IRS and Treasury, the Board should also confirm the extent to which the plan and parties to the plan are or are not exempt from the tax imposed on prohibited transactions under Internal Revenue Code §4975. The work of obtaining this confirmation should be addressed in the RFP.

No mention is made in the RFI of the application of federal securities and/or federal/state banking law to this plan and trust. The Board should determine the extent to which the California Secure Choice Retirement Savings Program is subject to registration with the Securities and Exchange Commission, what other requirements of federal securities law apply, as well as the application of banking law, if any, to the plan and trust. The work of examining this issue should be addressed in the RFP.

Conclusion

Our strong recommendation is that the RFI process be used to assess and decide upon the specific design and structure of the plans that the Board will propose, according to the provisions of SB 1234, and that will be tested in the RFP.



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